UNIVERSITY OF JOHANNESBURG

COPYRIGHT AND CITATION CONSIDERATIONS FOR THIS THESIS/ DISSERTATION

- Attribution — You must give appropriate credit, provide a link to the license, and indicate if changes were made. You may do so in any reasonable manner, but not in any way that suggests the licensor endorses you or your use.

- NonCommercial — You may not use the material for commercial purposes.

- ShareAlike — If you remix, transform, or build upon the material, you must distribute your contributions under the same license as the original.

How to cite this thesis

Surname, Initial(s). (2012). Title of the thesis or dissertation (Doctoral Thesis / Master's Dissertation). Johannesburg: University of Johannesburg. Available from: http://hdl.handle.net/102000/0002 (Accessed: 22 August 2017).

UNIVERSITY OF JOHANNESBURG

FACULTY OF LAW

THE CONSTITUTIONALITY OF DEEMED RATIFIED PRE-INCORPORATION CONTRACTS

PHEAGANE DAWID MOREROA

215085288

Mini-dissertation submitted in partial fulfilment for the degree of

MAGISTER LEGUM

IN

CORPORATE LAW

Supervisor: Prof SF du Toit

SEPTEMBER 2019

Declaration

I, the undersigned, hereby declare that the work contained in this mini-dissertation is my own original work and that I have not previously, in its entirety or in part, submitted it at any university in order to obtain an academic qualification.

Signature: ……. Date: ……...

Acknowledgements

I would like to express my appreciation to the following people, without whom this mini-dissertation would not have been possible:

To my supervisor, Professor Sarel du Toit, for your support, patience and guidance as well as your valuable contributions to my research.

To my mother, for your constant love and support throughout my years of study. Thank you for the interest you have shown in this study. Your faith in my abilities has enabled me to succeed in life.

A special thank you to my wife, Karabo, for your patience throughout this study and the valuable contributions you have made to it. Your never-ending support, love and motivation have enabled me to successfully complete this mini- dissertation.

To my close friends and colleagues who have made the past year memorable and truly enjoyable.

Table of Contents

1 *Introduction*

The ability to advance an economic opportunity in the business sector without an existing corporation has, for some time, been blocked by corporate obstacles. Individuals in pursuit of such economic opportunities may find it necessary to enter into contracts with third parties, and may wish to engage in such opportunities by using corporations, which are not yet established, or by using the corporation's name in the process of concluding a transaction. These economic opportunities may require an individual to acquire property (for example, leasing or purchasing real property), hire equipment or key employees, enter into finance agreements and line up suppliers in order to lock in clients.

The majority of individuals in such cases are compelled by circumstance to conclude pre-incorporation contracts in the name of, or on behalf of, a corporation. In practice, such contracts create no difficulty provided the contracting parties comply with all statutory requirements for a pre-incorporation contract or any other requirements for a valid contract. Pre-incorporation contracts pose no difficulty for the parties who benefit directly or indirectly from them. In most instances, when a corporation is established by a promoter, it would act in terms of the contract as there is an obligation on the corporation to ratify it.

However, a difficulty occurs when a corporation is not established, or after it has been established and due to its directed vision, the company rejects the pre-incorporation contract, either as a whole or in part. This refusal can cause a legal difficulty in the application of legal rights and the obligations of the parties involved.

In South Africa, the United States of America and Canada, the main concerns relating to pre-incorporation contracts are the extent of liability imposed on a promoter in a pre-incorporation contract and the extent of liability imposed on a company. Over the years, this field of law has developed significantly, with the United States of America and Canada applying the adoption approach, as opposed to the South African approach of ratification. However, all these countries have ancillary provisions that allow the parties involved to apply the law and, thus, create certainty without resulting in needless complexities and an unsuccessful application of pre-incorporation contracts.

In South African law, application of the law of pre-incorporation contracts encompasses an innovative provision of deemed ratification aimed to ensure continuity and prevent prejudice to contracting parties. The aim of this research is to explore the constitutionality around whether this innovative provision of deemed ratification is reasonable and fair in application, and whether the legislature should include a requirement of disclosure to the company's corporate organ prior to imputing liability to the company.

The inclusion of this requirement in South African law is, it is submitted, a fair and reasonable development that protects all the parties involved in the contractual relationship. In Canada, an indication of a reasonable development is reflected in the application of the principle of express waiver of liability and the apportionment of liability between the company and a promoter to prevent prejudice to contracting parties. In the United States of America, strict requirements are applied to ensure that the parties' intentions to a pre-incorporation contract are clear, prior to applying the principles of implied ratification. Furthermore, the Canadian jurisdiction follows an approach of implied adoption of a pre-incorporation contract to impute the liability of the contract on the part of the company, with some associated requirements of knowledge and intention, with the two being elementary before the declaration of liability.

This continued introduction of innovative steps to ensure reform to the regulation of pre-incorporation contracts indicates an existing need for pre-incorporation contracts in the business sector. However, the law of pre-incorporation contracts continues to be plagued with difficulties in the application of statutory requirements despite alternatives to such innovations being available. In order to best determine the above research question, the research shall include, firstly, a discussion on the composition of pre-incorporation contracts; secondly, a discussion on the process of ratification; and, thirdly, a discussion on the constitutionality of ratification on pre-incorporation contracts.

2 *Historical overview of pre-incorporation contracts*

Pre-incorporation contracts are recognised as written agreements made by a promoter acting on behalf of, or in the name of, a company not yet established, with a third party, with the intention of making the agreement binding on both the company and the third party once the company has been established. Pre-incorporation contracts, as previously regulated by the Companies Act 46 of 1926 and section 71 of Act 61 of 1973, remain applicable and enforceable within the business sector and are recognised in terms of the law. Such contracts are capable of ratification in terms of South African law, and adoption in terms of the Canadian law and the law of the United States of America, once the company is established. Once ratified or adopted, the contract is binding on the company, as though the company had existed at the time of conclusion of the contract.

In terms of section 71 and, after a consideration of various amendments[1] and reviews,[2] obligatory requirements were created that warrant liability on the part of a company.

[1] Companies Amendment Act 23 of 1939 and Companies Amendment Act 46 of 1952.
[2] In 1963, the South African government set up a commission called the Van Wyk de Vries Commission to examine the Companies Act 46 of 1926 which had never been consolidated with its amendments.

In its articles of association, a company had to have an object that it will ratify the contract or, alternatively, a company will acquire the rights and obligations in respect of such a contract, which would have to be concluded by a promoter who professed to act as an agent or trustee of a yet-to-be-established company.[3]

This remained the basis of regulation of pre-incorporation contracts until developments in the business sector necessitated a review of the Companies Act 61 of 1973. In order to create certainty in pre-incorporation contracts, an amendment to the position required that a copy of the pre-incorporation contract be lodged with the registrar together with an application to register a company.[4] Due to ever-changing business trends and the competitive environment created in this sector, it became evident that the pre-incorporation contract, open for inspection by the public, infringed on the affected parties' rights to confidentiality in dealings and their contractual privacy.[5]

All actions of the legislature were created to enable the business environment and to escape the bars set by common law.[6] The common-law position established in *Kelner v Baxter*[7] prohibited a company from ratifying a pre-incorporation contract concluded prior to its establishment and would necessitate innovation by states that sought to apply pre-incorporation contracts. In the *Kelner* case,[8] the court dealt with the question of whether the established company would ratify an agreement entered on its behalf by a promoter. In this case, the defendant, according to the terms of the agreement, acted "on behalf of a proposed company called *Gravesend Royal Alexandra Hotel Company Limited*".

The defendant entered into an agreement with the plaintiff for the sale of wine. In the course of the agreement, the defendant later incorporated the company and attempted to ratify the agreement,[9] which included the sale of wine; some of the wine sold under the purported agreement was used in the company's business. The business was not able to perform in terms of the contract and was unable to pay for the delivered wine,

[3] s 71 of Act 61 of 1973.
[4] s 50 of Companies Amendment Act 46 of 1952.
[5] A company as a juristic person has a separate legal personality that is distinct from that of its shareholders and is in law considered to be an abstract legal entity existing as a juristic reality in the course of the law, despite its lack of physical existence. A corporation as a statutory juristic person has the right to privacy as in *Financial Mail (Pty) Ltd v Sage Holdings Ltd* 1993 2 SA 451 (A).
[6] The common-law position provided that no agent on behalf of a company can perform juristic acts with the expectation that they will be ratified. The ability for one to conclude a juristic act on behalf of another involves the phenomenon of representation and representation becomes possible when a representative and a third party have intentions that a legal consequence from their conduct will ascribe to the principal and not the representative, whilst the third party has the intention that his or her conduct will therefore, create a legal relationship with the principal.
[7] (1866) LR 2 CP 174.
[8] n 7.
[9] On this point, it is important to note that ratification of a pre-incorporation contract at common law is not available, with reference to the case of *York Region Condominium Corp N 921 v ATOP Communications Inc* 2003 OJ 5255 SCJ p 5.

leading to the insolvency of the company. The plaintiff instituted proceedings to have the defendant held personally liable in terms of the contract and the court agreed thereto.[10]

The reasoning of the court was based on the fact that, given the inclusion of the agreement and the continued transaction, both parties were aware of the non-existence of the company. Nevertheless, the parties claimed to have concluded a contract. The court stated that a company that does not exist cannot conclude a contract and that both parties would likely have been aware of this. The court further stated that since both parties had the intention to conclude a contract, they must have intended to conclude the agreement with someone.[11]

The position of the court was such since the person referred to as "someone" could not have been the company, namely, Gravesend Royal Alexandra Hotel Company Limited. The agreement that was concluded must have been between the plaintiff (third party) and the defendant (promoter). The position was seen as an elimination process. If the company was not available to place liability in terms of the contract, the only person available was the promoter in their personal capacity.[12]

Despite developments in respect of pre-incorporation contracts, to overcome the common-law prohibition and in a bid to achieve trade efficiency, the legislature introduced further steps to overcome the common-law position whilst maintaining the core requirements of the regulation. Furthermore, the legislature also had a constitutional consideration aimed at promoting compliance with the object and purpose of trade provisions. Amongst some of these objectives, steps were taken to ensure the legislature achieved its mandate that was aligned to address challenges, whilst *inter alia* encouraging entrepreneurship and efficiency in order to create flexibility and simplicity in the formation and maintenance of companies.[13] In addition to this, it ought to encourage transparency and promote higher standards of corporate governance, given the significant role enterprises play within the social and economic life of a nation.[14]

As part of the legislature's development, steps were taken to introduce the Companies Act of 2008,[15] which has assisted in bringing about further changes in the regulation of companies in South Africa, including pre-incorporation contracts and by addressing potential infringements to the concerned party's rights.

[10] MacPherson "Law Reform in Corporate/Commercial Law in Manitoba: Pre-Incorporation Transactions - Part I" 2012 35-2 Manitoba Law Journal 49, 2012 *CanLIIDocs* 278
[11] n 7.
[12] Estey "Pre-incorporation contracts: the fog is finally lifting" (2000) 33 *Can Bus LJ* 3.
[13] s 7(b) (ii) of Act 71 of 2008.
[14] s 7(b) (iii) of Act 71 of 2008.
[15] Act 71 of 2008.

2.2 Brief overview of section 21 of Act 71 of 2008

Currently, the legal position states that section 21 of the Act [16] regulates the concept of pre-incorporation contracts. Also, in terms of section 1, the Act defines a pre-incorporation contract as:

> "… a written agreement entered into before the incorporation of a company by a person who purports to act in the name of, or on behalf of the proposed company, with the intention or understanding that the proposed company will be incorporated and will thereafter be bound by the agreement." [17]

This definition in its literal interpretation, infers that knowledge of the contract or consent by the contracting parties is not a necessary requirement to ensure its validity. Furthermore, in terms of this definition, these formalities are not essential for the enforcement of a pre-incorporation contract. From this definition, it is understood that the promoter concluding the agreement on behalf of, or in the name of, a company has to comply with the requirement of disclosure regarding his or her actions to the company's corporate organ. A further understanding is that such actions are conducted with the intention that once the company is incorporated it shall thereafter be bound by such contract.

A pre-incorporation contract, made on behalf of or in the name of a company, becomes binding or enforceable on the election of the corporate organ of such company. This is provided that the election is exercised within three months after the date on which the company is incorporated, to partially or conditionally ratify or reject the contract in terms of sub-section (4).[18] However, in terms of the Act,[19] a failure to exercise an election by the corporate body shall result in the application of sub-section 5, which provides that:

> "… if within three months after the date on which a company was incorporated, the board has neither ratified nor rejected the particular pre-incorporation contract, or other action purported to have been made or done in the name of the company, or on its behalf, as contemplated in sub-section (1), the company will be deemed to have ratified that agreement or action".

It is notable that the provision of sub-section 5 imposes on the established company an associated consequence of liability in terms of the pre-incorporation contract. In terms of the law of contract, a person is liable for damages in the case of a subsequent dishonour or cancelation of the contract by the company. It is a consequence that, if the contract is dishonoured or cancelled after it is deemed to be ratified in terms of

[16] Act 71 of 2008.
[17] s 1 of Act 71 of 2008.
[18] s 21(4) of Act 71 of 2008.
[19] Act 71 of 2008.

subsection (5), this would result in a parallel harsh and prejudicial consequence for the company.[20]

In South African law, the powers to exercise an election to ratify or reject a contract lie explicitly with the company's directors or its duly authorised agents who comprise the corporate body vested with the power to bind the company. It is submitted that a company's ability to reject or accept a contract requires that consent and knowledge of the contract be established, especially in light of the fact that the requirement to disclose a pre-incorporation contract in a company's constitution was abolished for the evasion of a party's confidentiality or privacy.[21]

Certain academics[22] suggest that developments in the law, in particular those occurring after the 1973 Act,[23] afford a certain degree of protection to a promoter who contracts on behalf of or in the name of a company. Maleka Femida Cassim is of the opinion that these developments continue to leave a third party unprotected and without a remedy should the establishment of a company or ratification by a company of the pre-incorporation contract, fail.[24]

In an inquiry into these developments, Cassim recommends that a better approach towards achieving a balance of the conflicting interest would be achieved by ensuring that a greater share of the risk of failure, in incorporation or ratification, falls on the promoter. Cassim's recommendation is supported by the consideration that courts, when faced with these situations, are of the view that a promoter's role in the incorporation of a company is better than that of a third party when it comes to understanding the likelihood of a company being established or a contract being ratified.[25]

Most academics[26] seeking answers to questions raised on these developments identified shortfalls in the various legislative instruments, including the 2008 Act. Ncube, however, writes that the Act and its predecessors:

> "… fail to offer some sort of protection for third parties, as it requires a promoter to disclose or 'profess' that he represents an unincorporated company. Such disclosure is in fact a warning to third parties – one which should accordingly place them on guard,

[20]Breach of contract - the law handbook 2008 (27 01 2019) https://www.lawhandbook.org.au/2019.

[21] The amendment of s 71 of Act 61 of 1973, brought about by s 50 of the Companies Amendment Act 46 of 1952.

[22] Ncube "Pre-incorporation contracts: statutory reform" 2009 126 *SALJ* 255; Ndaba "Pre-incorporation contracts and trusts: A summary of the basic principles in South African law" 2007 *DR* 36; Puri "The promise of certainty in the law of pre-incorporation contracts" 2002 *Canadian Bar Review* 1051; Cassim "Pre-incorporation contracts: The reform of section 35 of the Companies Act" 2007 124 *SALJ* 364.

[23] s 35 of Act 71 of 1973.

[24] Cassim "Pre-incorporation contracts: The reform of section 35 of the Companies Act" 2007 *SALJ* 364 368.

[25] *Westcom Radio Group Ltd v MacIsaac* (1989) 63 D L R (4th) 433 (Ont Div Crt) 69 p16.

[26] n 22.

> it alerts them to the need to negotiate with promoters and thereby secure accountability or liability of the promoter should the pre-incorporation contract fail."[27]

The current transformation or reform of company law, in particular the regulation of pre-incorporation contracts, still fails to address the complexities of these contracts. In light of their current status, these developments continue to afford protection to promoters and the interest of third parties whilst ignoring the company as another party to the contractual relationship. A company that is subject to a pre-incorporation contract remains unprotected from corrupt and predatory dealings by a third party and a promoter in the conclusion of the contract. These dealings are likely to hold the company liable on the pre-incorporation contract by a third party, based on the provisions of sub-section (5). When a company fails to ratify or reject a pre-incorporation contract within a statutory period of three months from the date of its incorporation, the pre-incorporation contract will be deemed ratified without the knowledge, consent or will of the company.

2.3 Stipulatio alteri

The area of pre-incorporation contracts in the Companies Act[28] has been subject to academic scrutiny,[29] wherein a comparison was made between the various acts and the interpretation of pre-incorporation contracts. These comparisons attempted to gauge whether the acts were suited to modern business trends and practices. Although some academics continue to question the relevance of these contracts, considering the availability of shelf companies, they nonetheless acknowledge that pre-incorporation contracts have a significant role to play, and will continue to play such a role, in the modern corporate world.

Through section 35,[30] the legislature previously provided for a pre-incorporation contract to be unenforceable until specific formalities where adhered to, thus, creating a further obstacle to parties finding flexibility in their ability to trade. However, parties had to find ways of dealing with these difficulties, as any validity and subsequent enforcement of a contract at that time was dependent on compliance with certain requirements or conditions to allow for the ratification or adoption of a contract. Firstly, this was to ensure that a company's memorandum of association upon its registration, contained as part of its objects, became an object to adopt or ratify a contract or the acquisition of rights and obligations in respect of such contract. This inclusion after

[27] Ncube "Pre-incorporation contracts: statutory reform" 2009 *SALJ* 255 258.
[28] Act 71 of 2008 and its predecessors.
[29] This includes writing by a number of authors. See n 22.
[30] s 35 of Act 61 of 1973, as amended by s 8 of the Corporate Laws Amendment Act 24 of 2006 provides a clear and direct explanation to the principle without any ancillary provisions which may have rendered compliance difficult. The difference in approach from the definition provided by section 35 and the current Act indicate variations to the line of jurisprudence where a greater consideration is made of the facts prior to apportioning liability.

registration would prevent further insertions from being placed into the memorandum of a company. In *Sentrale Kunsmis v NKP Kunsmisverspreiders (Edms) Bp*k,[31] the question was "when exactly in the memorandum of association would the object be absorbed". Secondly, copies of the contract had to be lodged with the registrar, together with the lodgement documents on the registration of the company's articles or its memorandum.[32]

Consequently, this became a lengthy process, which delayed parties in tying down a contract, especially in instances where parties sought to assert and protect their benefits. Undoubtedly, parties with an economic opportunity, without wasting time, would want to conclude an agreement and establish a legal personality in order to acquire their legal rights and obligations. In particular, this includes cases where one party seeks to secure a contract (office space) for an entity which is non-existent at that time.

In the midst of these obstacles, parties had an option to conclude valid agreements for the benefit of another non-existent third party.[33] This is done in a bid to avoid a statutory arrangement relating to a pre-incorporation contract and its formalities. The *stipulatio alteri* is concluded by the two contracting parties (the *stipulans* and *promittens*), creating a reasonable, legally-binding and enforceable obligation in favour of the third party. This, in turn, creates an obligation "an offer" to a *promittens* party who wishes to confer a benefit on the third party, which gives the third party an independent right to demand performance from the *promittence* upon acceptance.[34] It is, therefore, necessary that the party receiving the benefit accepts and ensures the contracting parties are aware of such an acceptance of the benefit. Alternatively, the recipient party must inform the contracting parties, prior to the party permitting the benefit from being released from its obligations.[35]

This option, when applied, enabled parties to trade and deal with the issue of the common-law principle of agency, which prohibited a person from claiming to act as an agent on behalf of a non-existent entity.[36] The difference with this option is that no representative concludes or creates a contractual relationship between a principal and an agent. When one person professes to act as an agent and concludes an agreement with the expectation that a company would ratify the agreement, such conduct, in terms of the common law, is prohibited as a person cannot derive authority from a

[31] 1970 3 SA 342 (A) 345.
[32] s 35 of Act 61 of 1973.
[33] *Crookes v Watson* 1956 1 SA 277 (A) par 285F; *Browns' Executrix v McAdams* 1921 AD 151 par 34; *Masterpiece Gold Mining Co Ltd v Brown's Executrix* 1914 AD 231 p 235; *Commissioner of Inland Revenue v Estate Crewe* 1943 AD 656; *McCullogh v Fernwood Estate Ltd* AD 204 206 215.
[34] *Mutual Life Insurance Co of New York v Hotz* 1911 AD 556 567.
[35] *Hofer v Kevitt NO* 1998 1 SA 382 (SCA) 387.
[36] In *Kelner v Baxter* 1866 LR 2 CP 174, it was held that "it is logically impossible for a person to act as an agent for a non-existent company".

non-existent company.[37] The conclusion of an agreement by an agent on behalf of a principal, regards the principal as the contracting party and not the agent. Whereas, with this option, a party contracts for the benefit of another.

The *stipulatio alteri* continues to be an ideal tool, usable in situations where parties are required to contract instantly. It is evident from the provisions of the Companies Act that this tool remains unaffected by the changes in the company's legislations with regard to pre-incorporation contracts.[38] Any resultant contract between parties involved in practice gives the established company an opportunity to accept or reject a contract once it has been established.

Prior to acceptance or rejection of a contract by a company, the parties mutually consent to the withdrawal of the contract and its offer. Furthermore, the *promittens* may not be unilaterally released from the contract by the promoter, as this would adversely prevent the company exercising an election to accept or reject the contract.[39] In the event of a repudiation of a contract by the *promittens*, the promoter may elect to cancel and be entitled to sue for damages, if any exist. Alternatively, the promoter may prevent the *promittens* from doing anything which may affect the contract offer.[40]

Once a contract is accepted by a company, the company acquires rights or duties in terms of the contract and can be able to compel performance by the *promittens*.[41] The *stipulatio alteri* continues to offer parties an opportunity to achieve a similar objective as a pre-incorporation contract, but without the need to comply with statutory requirements.

2.4 Company's interest in a pre-incorporation contract

In terms of the rules of natural justice and the Constitution,[42] a party is entitled to claim protection against any arbitrary conduct or any conduct that is against public interest. The court in *Terblanche*[43] provided that "corporations are a statutory juristic person (*persona juris*) in law considered to be an abstract legal entity which exists as a juristic reality in the contemplation of law despite the fact that it lacks physical existence". As such, a company yet to be established is considered as a legal person for the sake of safeguarding its current and future interest in the midst of infringements. There is,

[37] Accepted as correct in *Kelner v Baxter* 1866 LR 2 CP 174 by the court in *McCullogh v Fernwood Estate Ltd* 1920 AD 204 206.
[38] Hutchison and Pretorius *The Law of Contract in South Africa* (2012) 321.
[39] *McCullogh v Fernwood Estate Ltd AD 204 206, 215*; *Mutual Life Insurance Co of New York v Hotz 1911 AD 556 567*.
[40] Beuthin and Luiz Beuthin *Basic Company Law* (2000) 39-40.
[41] *JR 209 Investments v Pine Villa Estates* 2009 3 All SA 32 (SCA) 37.
[42] Constitution of the Republic of South Africa, 1996.
[43] *Ngcwase v Terblanche* 1977 3 SA 796 (SCA) 803H.

therefore, a need to protect the interests of a company that has not yet been incorporated.

A company as a separate legal person with a separate legal personality has the right to enjoy equal benefits of the law and protection in terms of the Constitution.[44] In *Manong & Associates v City Manager, City of Cape Town*,[45] the court stated that "the Constitution vests a juristic person with rights in the Bill of Rights to the extent required by the nature of the rights and the nature of the juristic person". As a matter of principle and public policy, it is essential that the legislature develops an opportunity and creates a requirement of knowledge to the terms of the contract by a company. This is primarily because a company's power to ratify or reject a pre-incorporation, prior to it becoming of value and enforceable against the company, is vested with the company's directors or corporate organ.

It is important to create the above requirement, as a company that is aware of the existence of a pre-incorporation is likely to accept or reject the terms of the agreement. An agreement that is reduced to writing can easily be shared with a company after establishment and before it becomes susceptible to ratification or rejection. This is primarily because "a written contract is an important component of a company's records, and ensures full and accurate disclosure within the company, for example from promoters to the directors".[46]

Although it may appear that the current Act has attempted to balance the conflicting interests of the involved parties while creating a justified improvement to the regulation of pre-incorporation contracts,[47] it is submitted that there continues to exist a form of masked unconstitutionality in the process of ratification in terms of the provisions of sub-section (5).[48] This masked unconstitutionality is evident insofar as the process deprives a company of the opportunity to have the right to disclosure of the terms of the agreement in protecting its corporate interest.

The lack of deemed ratification of pre-incorporation contracts, both in terms of the 1973 Act and the common law, raises the question of whether it can be practically implemented and whether there are flaws in the actual application of the process, as this theory has not been tried and tested against the principles of fairness or equality.

---

[44] s 9(1) of the Constitution of the Republic of South Africa, 1996.
[45] 2009 1 SA 644 (EqC) 34.
[46] Easson and Soberman "Pre-incorporation contracts: common law confusion and statutory complexity" 1992 17 *Queen's LJ* 414 447.
[47] Ncube "Pre-incorporation contracts: statutory reform" 2009 *SALJ* 269. Here, Ncube states: "section 21's reforms are commendable because they provide greater protection for the third party who enters into a pre-incorporation contract through the promoter's personal liability and the company's deemed ratification provisions. There clearly has been a policy shift towards a more balanced and nuanced treatment of third parties. At the same time, promoters and companies are also equitably treated".
[48] s 21 of Act 71 of 2008.

3 *Ratification of pre-incorporation contracts*

3.1 Overview of ratification

The law of contract provides that a written agreement only becomes binding against the contracting parties upon signature. Alternatively, in the case of an oral agreement, the agreement is only binding against the contracting parties upon knowledge and subsequent performance, in accordance with the conditions of the oral agreement.[49] An implied ratification method, applicable in pre-incorporation contracts, is one that may have practical difficulties as it could depend on a number of suspensive circumstances. The difficulty with this lies in the fact that the directors or the corporate organ of the company would have to signify its willingness to bind the company to the agreement by way of performance with such agreement.

It is important to note that any agreement concluded on behalf of another, with the intention of being binding on the party, must be adopted or ratified by that party. If the party adopting or ratifying is a juristic person, an essential prerequisite would be that the process of adoption or ratification be executed by the entity's appropriate organ or directors in order to enforce and exercise the company's freedom of choice in relation to that contract. This stems from substantial developments in South African law, which have transformed the view of pre-incorporation contract and influenced case law.

Ratification is in practice accepted as a confirmation or adoption of an act that has already been performed. In order to create certainty, the legislature provided that, in order for a party to validly ratify a pre-incorporation contract, the agreement ought to have been compliant with all statutory requirements. These include the requirement that the contract be made in writing; that a company's articles of association include as part of its objectives an object to ratify or adopt the rights and obligations associated with the contract; and, that the party who concluded the contract must have professed to act as a trustee or agent on behalf of the company to be incorporated. It is, therefore, essential that the professing person ensures compliance and subsequent registration of the company, which is an important requirement to a valid pre-incorporation contract.

It has, however, been suggested that the provisions of section 71 fell short of properly providing a convenient method of contracting. In particular, this section does not prescribe a manner or period during which parties are to adopt or ratify the concluded agreements. This causes a conflict in the determination of a valid enforceable agreement and creates an unreasonable delay in the exercising of rights by parties to the contract, which could result in expensive legal processes in an attempt by the

[49] Pinto AR and Brandson DM "Understanding corporate law (US: Matthew Bender & Company) Lexis Nexus 2003 27.

parties to enforce their rights.[50] In the matter of *Peak Lode Gold Mining Co Ltd v Union Government*,[51] the court confirmed the applicability of section 71. This section approves the ratification of a pre-incorporation contract concluded on behalf of an unestablished entity by an agent professing to act as such and on its behalf. However, the court provided that the approval by a company of a contract concluded before its incorporation does not have a retroactive effect. This continues to raise questions in the stage of retroactivity in a contract in order to be aligned with the principles of ratification provided by the common law.

3.2 Ratification of a pre-incorporation contract

The manner in which contracts are ratified differs from jurisdiction to jurisdiction. In South Africa, the law innovatively provides for a method of "deemed ratification". This is employed in instances where a pre-incorporation contract remains neither rejected nor ratified after it has been concluded by a promoter in the name of, or on behalf of, a corporation with a third party. This is applied in order to ensure parties are not prejudiced by the inactivity or deferrals by a corporate organ of an incorporated company.

In its effect, deemed ratification supports and creates a benefit to an interested third party from the point of reliance on a contract. The provisions of section 21(5) allow for a period of three months from the date of establishment of a company, to ratify or reject a contract. A failure by the company to ratify or reject a contract shall, therefore, create a deemed ratified pre-incorporation contract. The period offered by this provision, on the part of a third party interested in and relying on the contract, concomitantly creates a level of certainty from the date of establishment.

In a similar vein, this compliance period is also advantageous to promoters of a company. The advantage enables a promoter to avoid liability in terms of a pre-incorporation contract provided for and concluded in terms of sub-section 2.[52] Cassim[53] proposed that there be a solution to the conflicting rights and liabilities of the parties involved in a contract. She notes that there already exists a statutorily-implied dual warranty by a promoter, in the process of concluding a pre-incorporation contract. This dual warranty, in itself warrants that a company will be established and it further

[50] Ncube "Pre-incorporation contracts: statutory reform" 2009 *SALJ* 255 258.
[51] 1932 TPD 48 p 50.
[52] s 21(2) Act 71 of 2008 has the following impact: a person who does anything contemplated in subsection (1) is jointly and severally liable with any other such person for liabilities created as provided for in the pre-incorporation contract while so acting, if (a) the contemplated entity is not subsequently incorporated or, (b) after being incorporated, the company rejects any part of such an agreement or action.
[53] Cassim "Pre-incorporation contracts: The reform of section 35 of the Companies Act" 2007 124 *SALJ* 365.

warrants that the company established will ratify the contract and if not, a third party has an implied security in terms of sub-section 2(b).

The abovementioned interpretation practically creates an advantage to third parties contracting with promoters on behalf of a company. Third parties concluding an agreement in terms of this act are in the process implicitly assured that such a company will be established, and that should the company reject the contract, their rights in terms of the act remain reserved.

This statutory provision is seen as being an innovative aspect of the act[54] insofar as it is a unique manner of ratification, which is different from that of other states as not only a board resolution and/or conduct is an acceptable measure of signifying a company's intentions to be bound by an agreement. The South African aspect of deemed ratification has eased the situation and has given an advantage to promoters who purport to having concluded agreements on behalf of, or in the name of, a company. Through observation, it has also created an advantage for third parties[55] and has taken away the process that requires a third party to prove that a company's directors or corporate organ approved an agreement.

Amidst the various legislative changes, the 2008 Act and its predecessors[56] have all maintained a core requirement that a pre-incorporation contract must be in writing. This formality has been maintained in order to assure and create certainty for the company's corporate organ or shareholder in instances where a company is bound. This formality also ensures a full and proper disclosure of the terms of an agreement.

In the case of *Venalex Pty Limited v Vigraha Property CC*,[57] the court described the conclusion of a pre-incorporation contract concluded by three businessmen[58] who were also directors of another company called Betts Construction (Pty) Ltd, which wanted to extend its operations and lease property from another company that they intended to form. The company, represented by the three businessmen, was to purchase property from Vigraha Properties CC, which was represented by its sole member at the time of the conclusion of the pre-incorporation contract.

On 21 and 22 January 2014, a written document entitled 'Agreement of Sale and Purchase' was concluded for the sale of the property described by the seller, duly represented, and the three businessmen on behalf of the company to be formed. In terms of the agreement, clause three was headed "The Purchaser/s". Adjacent to this heading, the words "Pty/Ltd to be formed: Directors" were inserted in the manuscript

[54] Act 71 of 2008.
[55] Cassim "Pre-incorporation contracts: The reform of section 35 of the Companies Act" 2007 124 *SALJ* 365.
[56] s 71 of Act 46 of 1926 and also s 35 of Act 61 of 1973.
[57] 2015 2 All SA 645 (KZD) p 2-6.
[58] Messrs Betts, Morgan and Glasspool are directors of Betts Construction (Pty) Ltd and Venalex (Pty) Ltd.

and beneath the heading, in sub-clauses 3.1, 3.2 and 3.3, were the full names and identity numbers of the three businessmen.

The agreement complied with the necessary formalities for the conclusion of a pre-incorporation contract.[59] After the conclusion of the agreement, the businessmen, in a bid to establish the company, were advised to rather opt for a shelf company, which would be straightforward and will enable them to timeously purchase the property. The shelf company was then acquired and the directors (businessmen) concluded nominations wherein the company was nominated as a purchaser to the pre-incorporation contract.[60]

Pursuant to the conclusion of the nominations and an addendum giving the company occupation of the property, and the securing of payments to the company, the seller elected not to proceed with the sale on the basis that the company already existed at the time of the conclusion of the pre-incorporation contract. Another reason was that in the conclusion of the agreement, the directors purported to represent a company not yet incorporated.

The court held that it saw no reason why the acquisition of a shelf company could not legitimately be employed as a means of achieving the intended incorporated status of a company "formed" by, and amongst, the three businessmen who signed the agreement.[61] Thus, illustrating how ratification by a company of a pre-incorporation contract requires the ultimate cooperation of a company's directors or corporate organ upon establishment, as the intentions of the parties are central to the ultimate upholding of the contract.

Overall, it appears that ratification is an essential element of the validity of a pre-incorporation contract outside of a company's proven willingness to be bound by the contract. It is, therefore, advisable that a company be aware of any contract that is binding against it, as a binding contract can potentially adversely impact and deprive parties from achieving economic viability through companies. After considering that the proposed innovation can enable a third party and a promoter to bind a company to a contract prior to its establishment, it is advisable that there be measures set in order to ensure that the ratification system is not made susceptible to fraud.

[59] The purchaser and seller duly ensured compliance with the requirements provided in terms of the Act by ensuring the following:
- That the promoter purported to represent a company that was at the time not formed;
- the agreement concluded was a written agreement; and
- clause 17 of the agreement provided for liability on the part of the directors (promoters), in terms of the contract as provided by subsection 2 of s 21 of the Act.

[60] *Clifton et al v Tomb* 21 F 2d 893 (1927) 2.

[61] (n 57) p 28.

3.3 Lessons from other jurisdictions

In order to properly understand how a company can be bound by the decision of a promoter on a pre-incorporation contract, concluded with a third party on its behalf or concluded in its name, consideration must be given to other jurisdictions where there has been the strict application of formalities, to assess a valid contract ratified by a company, either impliedly through implied adoption, or, as noted in South Africa, through deemed ratification.

3.3.1 Lessons from Canada

The Canadian jurisdiction has, in its application of the law of pre-incorporation contracts, attempted to balance the interests of the parties involved in the process. It is notable that the South African perspective on proving a valid pre-incorporation contract only goes as far as complying with the formalities of a valid contract[62] and those of a pre-incorporation contract, as dictated by section 21.[63]

In a bid to ensure transparency and fairness in the application of the regulation and the subsequent enforcement of a contract, consideration is given to a reasonable time for a party to adopt the contract. In exercising the election, the Canadian authority applies the principle of adoption with significant consideration of the parties' intentions to be bound in terms of a contract. In order to confirm that a company has adopted a contract, through conduct or action, the element of knowledge of the terms of the contract is essential. This enables a company, through its actions or conduct, to adopt a contract, which is known to it and whose terms are enforceable.[64]

The corporate law statutes in Canada create the same position as that of the common-law position applied in South African law. This was exemplified in *Kelner v Baxter*[65] wherein a company is deemed not to exist until a certificate of its incorporation had been issued by an appropriate governing agency.[66] This common-law position and the Canadian jurisdiction do not allow enforcement of pre-incorporation contracts concluded by a company without a lawful legal status, in situations where parties require certainty. Prior to the passing of the interim report by the select committee on

---

[62] Refer to discussion on "consent and knowledge as requirement to deemed ratification" in par 3.4 below.
[63] Act 71 of 2008.
[64] Maloney "Pre-incorporation transactions: statutory solution" (1985) 10 *Can. Bus LJ* 409 419, 439.
[65] (1866) LR 2 CP 174.
[66] Canada Business Corporations Act R S C 1985 C-44 s 9 the Ontario Business Corporations Act RSO 1990 cB 16 s 7 the Alberta Business Corporations Act SA 1981 B -151 s 9 (1) and the British Columbia Company Act R.S.B.C 1996 c 62 s 12.

company law, the Lawrence Committee,[67] Canadian academics such as Francis Nugan, resolved that "some jurisdiction, and ultimately all jurisdictions in Canada, will develop a statutory solution which will remedy these unsatisfactory aspects of the law on pre-incorporation contract". Thereafter, and in the same year, the Committee agreed that the common-law position was fraught with difficulties for both the parties involved and the public at large. An enactment was, thus, proposed in the Ontario Business Corporations Act.[68]

It was the intention of the Federal Act (Canada Business Corporations Act) to balance the conflicting interests of the parties to the contract by making the promoter[69] personally liable. There was a co-existing right to any benefit based on a written[70] pre-incorporation contract. This contract was subject to certain discharging provisions including that: (i) there is an adoption of the pre-incorporation contract by the company within a reasonable time after its formulation; (ii) there is a promoter's right expressed providing against personal liability in the contract; and (iii) there be a right of a party to the contract to apply to the court to apportion liabilities between the promoter and the corporation.[71] This revoked the rules in the *Kelner* case, allowing for the adoption of the contract without the need for the creation of a new contract or assignment and creating no obligation on the part of the company to accept the contract; requiring no positive steps to be taken in the event of an election to accept the contract from the company.

The Canadian model and the South African model of pre-incorporation contracts have a common position: to protect third parties by imposing liability on the part of the company or the promoter in the event the contract is adopted or rejected. However, the Canadian statutes afford a promoter the opportunity to escape liability.[72] There is, however, possible conflict in the interpretation of the provisions as there is no distinct interpretation of what is considered to be "a reasonable time" for the purpose of the adoption of the contract by the corporation after incorporation, as opposed to the South African limitation of three months after the date of incorporation.[73]

---

[67] Ontario, 5th Sess, 27th Legis 15-16 Eliz II 1967 P10 par 1.5.3 (hereafter referred to as "Lawrence Committee").

[68] Business Corporations Act RSO 1970 c 53 s 20 repealed and replaced with the federal model section.

[69] In terms of the Canadian Business Corporations Act, a promoter is described as "a person who enters into a written contract in the name of or on behalf of a corporation before it comes into existence" (14(1)).

[70] A written agreement was a limitation created by the Canadian Business Corporations Act. This limitation was supported by R.W.V. Dickerson, J.L. Howard & L. Getz, Proposals for a New Business Corporations Law for Canada, vol. 1 (Ottawa: Information Canada, 1971) at 24-25 [commonly known as the "Dickerson Report"] because of the problems of proof associated with oral contracts and the need to ensure full disclosure of the terms of the contract to the corporation before adoption. However, both Ontario and New Brunswick have included oral contracts whilst adopting the federal model.

[71] s 14 of the Canadian Business Corporations Act, RSC 1985.

[72] Maloney (n 64) 414.

[73] s 21(5) of Act 71 of 2008.

In the case of *Inns of Canada Ltd v Horeak,*[74] Maurice J held that the repudiation of a contract by a promoter, accepted and relied on by a third party, precludes the corporation from subsequently adopting the contract, thereby placing a judicial limitation on the company's right to adopt under an identical provision in the Saskatchewan Business Corporations Act.[75] Considering that there are no statutory guidelines to determine a point of adoption of a contract by a company, this must be left as a question of fact to be determined by courts.

The Canadian jurisdiction provides that adoption can be by way of an action or conduct, thus, signifying the company's intention to be bound by the contract. As such, the parties can be certain of some factors, namely, that the company must perform some act or acts. The performance of the act or acts must be with knowledge of the terms of the contract, which is an implicit factor in the nature of intention. This symbiosis implies that the company is deemed to have adopted the contract and the promoter has been relieved of liability for the contract, subject to a court application to apportion liabilities.[76]

It is clear that the Canadian view of adoption, either through deemed or formal adoption, is subject to a company's performance of certain acts or actions to signify the company's intention. The clearest form of formal adoption would be by way of a formal resolution by the company's directors or corporate organ, electing to adopt the contract. The courts in the Canadian jurisdiction have previously held companies liable in terms of a contract where, with knowledge of the contract, the *status quo* is continued without objection or repudiation. This is particularly evident in employment contracts.[77]

The performance of certain actions or acts by a company is seen as evidence of adoption, including any payments by a company in terms of a contract.[78] However, other cases suggest that mere deposits made by a company will not be sufficient without more evidence. This, therefore, places a requirement of substantiality in the payment, as in the case of *Okinczyc v Tessier.*[79] Further to the applied inferences on the process of adoption, the Canadian courts have provided that a claim of rights in terms of the contract, or on the other hand, defending and replying on it, may be sufficient.[80] They also held that mere silence by the board of directors or their failure to protest a claim on a pre-incorporation contract would not be enough to signify their

[74] 1982 18 Sack R 30 1982 2 WWR 377 (QB).
[75] s 14 of Corporations Act SM 1976.
[76] (n 64) par 409 439.
[77] *McArthur v Times Printing Co* 51 NW 216 (Minn 1892) 321 and *Meyers v Wells* 31 NW 2d 512 (Wis 1948) p 106.
[78] *Re Quality Shoe Shop Inc* 212 F2 321 (E D Penn 1914) P 212 and *Webber v George F Lance Co* 237 F 357 (3d Cir 1916) par 23.
[79] *Okinczyc v Tessier; Okinczyc v Berket* (1979) 8 RPR 249 (Ont HC J) 175.
[80] *Meyers v Wells* 31 NW 2d 512 (Wis 1948) 356. However, the court also considered the other evidence suggesting adoption, which included the acceptance of benefits over a long period of time.

rejection of a contract.[81] Instead, it would create an impression of the company's intention to adopt some or all of the terms of the contract, thus, accepting liability as evidenced in the case of *Stone v First Wyoming Bank.*[82]

There is, therefore, an underlying conclusion that one can reasonably determine the existence of an informal adoption of a pre-incorporation contract by a company. This includes the performance by a company of the terms of a contract,[83] the acceptance of benefits under a contract[84] and the imputed knowledge[85] of a contract by a company. An informal adoption may also be witnessed in a company that is found to be performing the obligations owing in terms of a contract and that is fundamental in any determination. The Canadian Federal Act requires intention in order to hold a company bound to a contract.[86] Acceptance or intention requires two elements which are important to impute liability. These two elements are: (i) knowledge and (ii) voluntariness. These elements play a significant role in the interpretation or determination of adoption in relation to pre-incorporation contracts. The comments in the federal proposal for a New Business Corporations Law submitted by Dickerson and others,[87] on the necessity to ensure full disclosure of the terms of a contract suggests that the Canadian jurisdiction regards knowledge of a contract as an important prerequisite for the valid adoption of a pre-incorporation contract. The insistence on knowledge of the terms of a contract assists a company from having unwanted contractual associations or obligations thrust upon it by the unwitting use of benefit of a contract.

The Canadian perspective of corporate knowledge is that, it can be implied through an acquisition by its authorised agents, which knowledge is not merely imputed to the company. A determination of the authority of the acquirer of the knowledge is fundamental, as the capacity in which the knowledge is acquired and used creates opportunity to easily impute knowledge to the company. In *Gardiner v Equitable Office Bldg Corp,*[88] Rogers J held that "[a] corporation is not charged with notice of facts to a director in a transaction between him and the corporation. The knowledge of a promoter is not to be imputed to his corporation."[89] This is so as it may result in having unwanted contracts accepted on the company's behalf by a self-interested party in a bid to rid himself of personal liability by accepting such contracts and prejudicing the

[81] *Cushion Heel Shoe Co v Hartt* 103 NE 1063 181 Ind 67 LRA NS 979 (1924) 467.
[82] 625 F 2d 332 (10th Cir 1980) par 13.
[83] *Dealers Granite Corp v Faubion* 18 SW 2d 737 (Tex Civ App 1929) 45.
[84] *Jacobson v Stern* 605 P 2d (Nev 1980) 198; *Framingham Savings bank v Szabo* 617 F 2d (1st Cir 1980) 897; *Bankers Trust Co of Western New York v Zecher* 426 NYS 2d (Sup Ct 1980) 960.
[85] *Wall v Niagara Mining & Smelting Co* of Idaho 59 P399 (1899) 59; *Re Ballou* 215F 810 (ED Ky 1914) 302.
[86] s 14(2) of the Canada Business Corporations Act SC 1974 – 75 – 76 c 33 as amended.
[87] Dickerson, Howard and Fertz submitted a proposals for a New Business Corporations Law for Canada (Ottawa, Information Canada 1971).
[88] *Gardiner v Equitable Office Bldg Corp* 273 F 44117 ALR 431 (CC-2 (2d Cir 1921) 412.
[89] (n 81) par 446.

company and its investors. The implications of this interpretation has never been that knowledge by a promoter who later turned director will ever be imputed to the company, but rather it must be shown that the knowledge is present in the promoter-director's mind when acting for a company in a transaction in which it is material.[90]

The extent of the knowledge required to constitute adoption can be as that provided by Cochran J insofar as "the corporation should have full knowledge of the facts, or at least should be put upon such notice as would lead, upon reasonable inquiry, to knowledge of the facts".[91] This, together with some modifications to statutes, can assist in determining what constitutes adoption. The flexibility created by the Canadian and South African approaches to pre-incorporation contracts, has exposed a risk in the management of the contracts. When a contract is deemed to be ratified or is deemed to be adopted, the possibility poses a risk to a company involved in the concluded pre-incorporation contract. In South African law, the 2008 Act requires that a company fails to either accept or reject the contract for a period of three months, whereas in Canadian law, there is a requirement to establish an awareness by a company of the fundamental terms of a contract.

3.3.2 Lessons from the United States of America

In the United States of America, an important pre-requisite for holding a company liable for a pre-incorporation contract is full knowledge of the facts, or at least proving that the company was put upon such notice as would lead, upon reasonable enquiry, to knowledge of the facts.[92] In many instances, where a company has been bound by the decisions of a promoter, the courts have, after consideration of various facts, found great difficulty in finding a scientific or rational reason for continuing to investigate the basis for the company's liability. The courts, which have previously found that companies are bound by the decisions of the promoters, based their decisions on grounds of ratification, adoption, novation, and that the proposition made to the promoters was a continuing offer, to be accepted or rejected by a corporation once it came into being. Alternatively, upon acceptance, it becomes an original contract, and the company has thereby sustained liability on the grounds that by accepting the benefit of the contract, it takes *cum onere,* and is, thus, estopped from denying liability.

In the case of *Clifton v Tomb*,[93] the court of appeal had to determine two questions: (i) whether the district court had erred in dismissing the bill in equity and the corporation's counterclaim; and (ii) whether the court had erred in refusing to allow the corporation to proceed upon its counterclaim *pro confesso*. This enquiry developed after the jury

[90] (n 81) par 447.
[91] *Clifton v Tomb* 21 F 2d 893 (4th Cir 1927) p 71.
[92] *Buffington v Bardon* 80 Wis 635 50 NW 776.
[93] (n 91) par 74.

in the district court had granted judgment and awarded M H Tomb ("the plaintiff") a sum of $10 000 against J B Clifton ("first defendant") and West Virginia Corporation for a claim for payment for stocks in the corporation.

Tomb, in his substituted agreement, claimed $20 000 of stock in the corporation. In considering evidence, the court[94] found that in 1920, the West Virginia Corporation, Raven Red Ash Coal Company, was considered by Tomb and others to be a very valuable property. At that time, Tomb obtained, for himself and certain associates, an option for the purchase of the entire stock of the corporation on certain terms. This option was taken in Tomb's name, making him the sole owner of all the interests in this option.

Tomb approached Clifton with an agreement that he would transfer the option to Clifton for the sum of $20 000.[95] At the time of transfer, the West Virginia Corporation had not yet been formed. However, after the transfer, Tomb and Clifton agreed that *in lieu* of the $20 000 that was to be paid for the option, Tomb should receive $20 000 in stock of the company which Clifton and certain associates intended to form, and to take over the stock of the West Virginia Corporation under the option. Tomb had to give his notes as if he is a *bona fide* subscriber for that amount of stock to ensure compliance, and protect himself should he be called upon to pay the notes ("secret agreement"). In an understanding between Clifton and Tomb, it was understood that Tomb was to obtain his stock and not pay the notes, which were to be kept secret. Clifton took over the option for the benefit of himself and the other stockholders. There were, however, no written subscriptions by the stockholders of the West Virginia Corporation, which was formed and the option was transferred thereto. . Furthermore, there was no evidence that Tomb was to receive anything for the option under either the original agreement with Clifton for payment in money, or the substituted secret agreement for payment in stock. It appears Tomb gave his notes for the stock, pursuant to his understanding with Clifton, and these notes were carried by the corporation. Thereafter certain stock assessments were made, for which Tomb gave his notes. As a result of the understanding with Clifton, these notes were not to be paid and the agreement should be kept secret.

On consideration, the appeal court, found that the substituted agreement upon which Tomb had based his claim, was fraudulent against the corporation and the other stockholders, and should never have been enforced by the district court in granting the order against Clifton and the West Virginia Corporation. This is a result of the corporation not being legally bound by the original contract with Clifton, as at the time it had not yet been formed. Clifton was merely a promoter as it was termed and was one of the incorporators of the corporation once it was formed.

---

[94] (n 91) p 89.

[95] This approach was based on an agreement that Tomb was to sell the option of all the capital stock of the West Virginia Corporation to Clifton for $20 000 and he would afterwards, instead of paying the $20 000, deliver to Tomb that amount of stock of the West Virginia Corporation, which he expected to organise.

The appeal court found that, since a corporation, before its origination, cannot have agents, and is unable to contract or be contracted with, and the corporation is not liable upon any contract which a promoter attempts to make, unless it occurs by its own act after its incorporation is completed.[96]

Tomb claimed that due to the fact that the West Virginia Corporation had his notes, as transferred by Clifton, he could rely on the ground of retention of benefits in order to hold the West Virginia Corporation bound by the original agreement for payment in money for the option,[97] as concluded by Clifton. Furthermore, the court found that considering whatever legal theory applied, a corporation may be bound by the contracts of the promoter, including the theory of implied ratification as in all cases knowledge of the facts is critical to imputing liability to a corporation.

The concept of adoption was also applied differently in *McCloskey v Charleroi Mountain Club*.[98] *In casu*, McCloskey sought to establish his status as a member of the Charleroi Mountain Club, a non-profit corporation dissolved in 1953. He sought to have its dissolution set aside in order to receive a 1/29th share of the property of the club and obtain an account of the proceeds received from the leasing of the property of the club since 1953 subsequent to its dissolution. The club was organised by a group of sportsmen for the purchase of a tract of mountain land suitable for recreation, hunting and fishing, and to maintain the tract so acquired as a game preserve. In 1953, the corporation was dissolved and distributions in kind were made to the members, who thereupon granted an exclusive mineral lease to the Kota Gas Oil Company in return for the payment of royalties.

The contention was that McCloskey had been a subscribing member of the club from the date of its incorporation to the date of the institution of his action but had never received notice of the attempted dissolution nor shared in the distribution of the club's property, and that consequently the dissolution was invalid. McCloskey went on a quest to prove his members wanted to produce witnesses, who were among the original incorporators, promoters, members and officers of the club. The witnesses were also to prove that a pre-incorporation agreement had been made between the club and McCloskey, by virtue of which he had become a member of the club for life (without payment of initiation fees, dues or assessments). This was in consideration for the legal services he had performed, and was to continue to perform for the club, as a promoter. The offer was refused on account of the corporate by-laws that provided for membership exclusively upon payment of dues and initiation fees, and that the Parole Evidence Rule prevented the introduction of testimony to prove membership in the club as of the time of its dissolution.

In an appeal, after the court entered a nonsuit due to the lack of proof of his membership in the club as of the time of its dissolution, McCloskey averred that when

[96] (n 91) p 90.
[97] This theory in the United States called "the theory of implied ratification".
[98] 390 Pa 212 (1957) 21.

an agreement is entered into between incorporators and a promoter, whereby pre-incorporation services are to be performed on behalf of a corporation in return for a specific compensation, the contract may be adopted, accepted or ratified by the corporation when organized.[99] The corporation then becomes liable both at law and equity on the contract.[100] In the appeal, the court held that a corporation which adopts by-laws prior to incurring an obligation inconsistent therewith by its conduct, may waive its by-laws and estop itself from disclaiming liability on the ground that its obligation was incurred in contravention of its by-laws.[101] In order to prove acceptance and adoption of the pre-incorporation agreement, McCloskey noted the acceptance by the corporation of legal services rendered after its incorporation; its issuance of a membership card to him; and the admissions by several of the members that he was a life member of the club. Accordingly, the decision by the court of common plea were reserved and the case was remanded for further proceedings.

3.4 Consent and knowledge as a requirement for deemed ratification

In order for a legally binding contract to exist between parties, the laws regulating contracts require compliance with certain requirements. A pre-incorporation contract is another form of contract enforceable in terms of the law, if the requirements are complied with, namely:[102]

- The parties must have the capability to enter into valid contracts;
- There must be agreement;
- The contract must comply with any formalities by law or agreement;
- The contract has to be clear and certain;
- There must be possibility of performance by either party to the contract; and
- The contract must comply with the requirement of legality.

In general, most contracts have no stringent formalities and do not need to comply with a particular format, as most do not require a written agreement but can be concluded either verbally or by actions. In the instance of the Companies Act,[103] section 21 maintains the formalities of a written agreement as part of the general requirements to ensure that a contract is valid. This section, however, does not stipulate the agreements that can be concluded in the form of a pre-incorporation contract. Formalities may be required, either in terms of the law or by the contracting

[99] *Girard v Case Bros Cutlery Co* 225 Pa 327 74 A 201.
[100] *Bonner v Travelers Hotel Co* 276 Pa 492 120 A 467.
[101] *Shellenberger v Patterson* 168 Pa 30 A 943.
[102] Bhana, Bonthuys & Nortje Students' Guide to the Law of Contract (2015) 4th ed Juta p64.
[103] Act 71 of 2008.

parties themselves. In instances of agreements regarding the sale of immovable property or suretyship, the law prescribes certain formalities. A contract for the sale of immovable property must be in writing and signed by the contracting parties. If this formality is not complied with, the contract is void. A surety agreement has to be in writing, as the third party (surety) guarantees that if a debtor does not honour an obligation to a creditor, the surety will be personally liable to the creditor.[104]

Upon consideration of statutory formalities, a question may arise as to whether a pre-incorporation contract may take the form of a sale of immovable property or a suretyship agreement. This is because the requirement of certainty is important to the question of disclosure of the contents of the pre-incorporation contract to the corporate organ of a company incorporated by a promoter. Performance in terms of the law of contract refers to that which each of the parties in the contract is obliged to do. If the contract fails to state clearly what performance is required, the contract is void due to uncertainty. The corporate organ of the company must be in a position to determine the certainty in the agreement terms and the possibility of performance, which will enhance the company's right to trade and promote its values.

The nature of a suretyship places a heavy burden on the surety, wherein a third party is guaranteed that if a debtor does not honour an obligation to the creditor, the surety will be liable to the creditor. The law imposes a formality that the contract is to be in writing and signed by the surety and, if not complied with, the suretyship is void and can be ignored. A written agreement creates certainty in terms of an agreement as it clearly sets out the performance required by each party.

However, when the terms are certain, and an agreement is in writing, a contract will still be deemed to be invalid due to the impossibility of performance by the parties. The usual questions relate to subjective and objective impossibility.[105] The questions require determination by a company prior to it reaching a decision to reject or ratify a pre-incorporation contract. The company's right to association[106] is affirmed by the provided formalities, required in a valid agreement (pre-incorporation contract). It is during the process of ratification or rejection that the corporate organ of the company agrees or disagrees with the intended contract. Commonly, when parties misunderstand each other because certain facts or circumstances are viewed or understood differently. The law refers to this as a unilateral mistake;[107] where there is a common mistake or when there is a shared, mistaken understanding.

[104] Du Bois (ed) *Willie's principles of South African Law* (2007) 110.
[105] Subjective impossibility is a condition of impossibility; when created, it is not completely impossible for a party to perform while objective impossibility is a condition where the performance is completely impossible for any party of performs at the time of conclusion of the contract.
[106] s 18 of the Constitution of the Republic of South Africa, 1996.
[107] Either one or both of them could be wrong in the interpretation or view but there is a cross-purpose with the other.

A company's corporate organ that is unaware of the purpose of the contract or the contract may, in terms of subsection (5) of section 21 of the Act, be deemed to have ratified a void contract. This would be due to the fact that no agreement was concluded on its behalf and or in its name. A concomitant consequence would be relieving the promoter of liability in terms of the contract, with an obligation to perform in terms of the contract. However, in the event that the company seeks to protect its interests and declare the contract void due to no agreement or a mistake, the company will suffer damages in protracted legal proceedings, which will result in the incurrence of legal costs. It is unfair for companies without financial capacity to institute and sustain a lawsuit caused by deemed ratification and the obligation to perform in terms of a void pre-incorporation agreement.

Furthermore, the law of pre-incorporation contracts requires compliance with the requirement to have the contract in writing. This is inclusive of an oral contract between parties, which is subsequently reduced to writing. In *Akromed Products Pty Ltd v Suliman,*[108] in order to ascertain the intentions of the parties and to confirm consensus in the conclusion of the contract, De Villiers J considered the intention of the defendant to conclude the contract in his personal capacity or that of his de-registered company. The defendant stated that he had no intention of contracting in his personal capacity, however, De Villiers J later admitted that, in his capacity as director of the de-registered company, he had concluded the contract. The court found that the evidence was clear insofar as the defendant had not concluded the contract in his personal capacity, and the third party had intended to conclude the agreement with the company. The knowledge of the terms of the contract and the implications of the contract were clear. However, to hold the director personally liable would require another contract, with clear terms that dictated that the director would be held personally liable in order to be binding.

In order to perform its obligations owed to the company (incorporated or not), the corporate body of a company is required to establish and understand the objects of that company. Alternatively, it needs to understand the directed vision, which the shareholders adopted prior to their conclusion of contract and the ratification or rejection of pre-incorporation contracts. It is, therefore, fair that the requirement for a written pre-incorporation contract, in relation to an unincorporated company, is a systematic record and disclosure of information. This is needed for the directors or the corporate body and a company to ensure the effective exercise of their right to trade,[109] and to make the necessary choices to assist the company in exercising its constitutional rights. The right to information[110] held by a company in respect of a pre-incorporation contract, allows the corporate body of a company to advance the

[108] *Akromed Products Pty Ltd v Suliman* 1994 1 SA 673 (T) 75.
[109] s 22 of the Constitution of the Republic of South Africa, 1996.
[110] s 329(1) of the Constitution of the Republic of South Africa provides that everyone has the right to access to information (a) any information held by the state, and (b) any information that is held by another person and that is required for the exercise or protection of any rights.

company's rights, creating an obligation of disclosure to the promoter and the third party.

It is clear from the right of access to information, as enshrined in section 32,[111] that there can be no restriction to persons allowed to access information or a specific type of information. The reference to information is not only limited to documentary or recorded information; the concept of information is one that suggests that access refers to information that is known or current. It may be argued that it is not necessary to disclose information about the contract to a company by the reliant party or agent. However, in order to ensure the effective prevention and detection of collusion and corrupt dealings between a promoter and a third party, it is, in fact, necessary considering the level of advantage created by section 21 of the 2008 Act.[112]

It is common cause that the promoter and the third party fall within the category of subsection (1) (a) of section 32 of the Constitution,[113] and that the section is interdependently related to the protection of another right. The right of an unincorporated or incorporated company to trade and, moreover, to trade in an industry of choice and associate with other entities of choice, requires protection. The protection of these rights is dependent upon the corporate body's access to information related to the contract and any other information required to exercise or protect the company's rights after a purposive, contextual and holistic consideration of its rights in the Bill of Rights.

3.5 Disclosure of the terms of the contract to ensure deemed ratification

Section 21 of the Act does not provide for the disclosure of the contract terms to the company, to the incorporator, a director or shareholder by the promoter. It is submitted that this appears to be an oversight that has the potential to allow the contracting parties, prior to the company's establishment, to collude or defraud the company. The oversight leaves the company's rights and interests open to infringement and abuse. It is, therefore, essential to ensure the company established is directed and managed by an informed, active and engaged corporate organ, whilst remaining mindful of the fact that shareholders can only properly hold the appointed directors or corporate organ accountable if the directors or corporate organ is relatively informed and aware of issues involving the company.

[111] The Constitution of the Republic of South Africa, 1996.
[112] It is submitted that s 21 continues to create a level of certainty in the position of the agent and the third party reliant on the pre-incorporation contract. This is because the agent is left with the consequence of personal liability while the third party is placed in a position of loss if he has performed in terms of the contract or has to claim performance from an agent not in a position to reciprocate his performance or to reinstitute.
[113] n 111.

In order to assess this constitutional oversight in the 2008 Act, it is necessary that we consider balancing the parties' rights objectively by examining the 2008 Act against the Constitution, whilst further determining the viability of the provision of deemed ratification. In law, the invalidity of any law is determined by an objective enquiry and that a statute is of no force and effect to the extent of the inconsistency, as provided for in section 4(1) of the Interim Constitution Act 200 of 1993.[114] However, it has further been provided that in the case of disputes, the subjective position in which parties find themselves may not have a bearing on the status of an Act.[115]

This is mindful of the need for a systematic and continuous recording of a company's affairs by the corporate organ. Other parties could argue that parties may, through the Promotion of Access to Information Act (hereinafter referred to as "PAIA"),[116] access information of the company. This is because a company falls under the definition of a private body and its records are available upon request. As a statute, PAIA, requires a specification of requests in a prescribed form that is relatively detailed and contains sufficient particularity to enable the identification of a specific record.[117]

It is, therefore, sensible that such access be afforded to the requestor based on specific existing records that are known to him or her. This would create a consequent obligation to lodge a separate request each time the requestor is of the opinion that there may be information which is undisclosed. This application does not, however, cater for an obligatory duty to disclosure by the promoter or third party to the directors or corporate organ of the company after incorporation. The constitutional right to access to information, read together with the right to trade and the right to freedom of association, makes it necessary for a corporation to have knowledge of a contract in order to exercise its rights. When a company has no knowledge of a contract, an onerous burden is imposed which necessitates the search for any pre-incorporation contracts concluded in its name or on its behalf in order to avoid liability in terms of section 21(5).[118]

According to PAIA, the request and subsequent disclosure of a company's information may alternatively be in terms of section 70.[119] Primarily, this would be used to elicit information held by a promoter and a third party, which has an arduous threshold imposed in case of execution of a contract to indicate that the request for information

[114] *Ferreira v Levin NO; Vryenhoek v Powell NO* 1996 1 SA 984 (CC) p 26-28.
[115] *My vote counts NPC v President of the Republic of South Africa and others* (13372/16) 2017 ZAWCHC 105 p 33.
[116] Act 2 of 2000.
[117] s 18(2) of Act 2 of 2000.
[118] s 21 Act 71 of 2008.
[119] s 70 of Act 2 of 2000 "Mandatory disclosure in public interest". Despite any other provision of this chapter, the head of a private body must grant a request for access to a record of the body contemplated in s 63(1), 64(1), 65, 66*(a)* or *(b)*, 67, 68(1) or 69(1) or(2) if - *(a)* the disclosure of the record would reveal evidence of - (i) a substantial contravention of, or failure to comply with, the law; or (ii) imminent and serious public safety or environmental risk; and *(b)* the public interest in the disclosure of the record clearly outweighs the harm contemplated in the provision in question.

was to enable the company to substantially comply with the law and prevent difficulty in execution based on the deemed ratification of an unknown pre-incorporation contract.

Alternatively, parties that do not want to undergo the process as provided for in terms of PAIA, and if they are aware of the concluded pre-incorporation agreement, can request a copy thereof from the promoter. This will, however, prove to be impossible in instances where there is collusion between the promoter and a third party, wherein the promoter may not disclose the existence of an agreement concluded in the name or on behalf of the company. Instances wherein a third party colludes with a promoter to defraud a company through a pre-incorporation contract may result in the agreement being kept a secret for the duration of the statutory compliance period of three months in a bid to achieve deemed ratification.

An application to compel disclosure of any contracts concluded in the name or on behalf of the company before establishment of the company, may be prompted by a company's directors or corporate organ which may cause the company to incur an unnecessary legal expense. It is, therefore, cost effective to initiate a request in terms of PAIA and obtain copies of the agreement.

4 Constitutional aspect of deemed ratification

The developments in the field of company law must be weighed against public interest, particularly the South African Constitution,[120] insofar as the promotion of the principles of accountability, transparency, reasonability and fairness is concerned. There is a need for companies to have knowledge of pre-incorporation contracts concluded in their name or on their behalf when applying the process of deemed ratification since this has a direct consequence on the company's right to trade.[121]

This constitutional right can be protected and ultimately enforced, as a company's right to access to information is also protected. Section 32(1) (b),[122] read together with section 22[123] of the Constitution, makes clear that the right of access to information is held by everyone and that no restrictions exist on who may access the information. The idea of information held can be taken to mean information known or currently available to another. Sub-section (1) (b), therefore, provides instances of two holders of information and, in terms thereof, it is submitted that there is a need to re-align the interpretation of the sections with the concept of pre-incorporation contracts. There is a qualified right in the section which is held by another person that information must

[120] Constitution of the Republic of South Africa, 1996.
[121] s 22 of the Constitution provides that "every citizen has the right to choose their trade, occupation or profession freely".
[122] s 32(1)(b) reads that "[e]veryone has the right to access any information that is held by another person and that is required for the exercise or protection of any other rights".
[123] The right to freedom of trade, occupation and profession.

be requested in an attempt or with the intention to protect or exercise any rights. It is, thus, fair to state that third parties, either natural or juristic persons and promoters fall within the category of "another person" as referred to by the section. Furthermore, the section provides an unqualified right to information held by state.

When considering the holistic, contextual and purposive considerations of the Constitution's Bill of Rights, the manner in which the South African courts interpret the legislation and give effect to the rights requires modification. It is fair to pronounce that an unincorporated company's board of directors, which is vested with the right to conduct the company's business and manage the company, ought to be informed of the pre-incorporation contract together with its required[124] contents. This would allow the board to weigh up a contract's beneficial interests for the company and determine whether its objectives are in line with the company's vision and values.

To give proper effect to a company's right to information as a right in the Bill of Rights, it is common cause that PAIA was enacted to give effect to this right, regardless of whether the information was in the hands of a public or private body. Furthermore, ordinarily and according to the principle of constitutional subsidiarity, claims to enforce the right to access to information must be based on PAIA.[125]

The right to access information should, therefore, be generously and purposively interpreted in order to give the holder the fullest protection. In addition, section 39(2)[126] of the Constitution imposes an obligation on all courts and/or tribunals to promote "the spirit, purport and objects of the Bill of Rights" when interpreting legislation. In *Phumelela Gaming and Leisure Ltd v Grundligh,*[127] the Constitutional Court observed that:

> "… a court is required to promote the spirit, purport and objects of the Bill of Rights when 'interpreting any legislation, and when developing the common law or customary law'. In this no court has discretion. The duty applies to the interpretation of all legislation and whenever a court embarks on the exercise of developing the common law or customary law. The initial question is not whether interpreting legislation through the prism of the Bill of Rights will bring about a different result. A court is simply obliged to deal with the legislation it has to interpret in a manner that promotes the spirit, purport and objects of the Bill of Rights. The same applies to the development of the common law or customary law".

[124] With reference to the case of *Clutcho (Pty) Ltd v Davis* 2005 3 SA 486 (SCA) par 13, the terms "required" in the context of the constitutional right to access to information held by another person, does not represent absolute necessity. In the case of a company incorporated post the pre-incorporation, it must then establish a substantial advantage or element of need, as the standard appears to be flexible and accommodating in its fact-bound application.
[125] *Mazibuko v City of Johannesburg and Others* 2010 3 BCLR 239 CC par 73.
[126] s 39(2) provides: "When interpreting any legislation and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights."
[127] 2006 8 BCLR 883 (CC) par 27.

It will, however, be difficult for a company to formulate an opinion that there exists a pre-incorporation agreement, which may require the company's adjudication without probable knowledge of its existence. A statutory obligation to disclose any pre-establishment acts or conducts, which have a legal bearing is key to the protection of a company's rights to access information; the right to be able to choose a sector of trade and the specific group of association in the industry. A discussion on the protection of a party's right to access information to protect and exercise a Constitutional right is evident in the case of *My Vote Counts NPC v President of the Republic of South Africa*,[128] wherein a non-profit organization sought the court's intervention in granting an order that citizens be entitled to information concerning the private funding of political parties.

Included in the argument by the organization, was the belief that access to such information would allow citizens to effectively exercise their right to vote and make political choices in terms of the Constitution. The benefit of having access to information, including access to a copy of the pre-incorporation contract concluded prior to a company's establishment as in this case, or rather the benefit of having access to private funding information of a political party, is imperative as it creates an active, informed and engaged citizenry. The public can only and properly hold their elected representatives accountable if they are sufficiently informed of the relative merits of issues.[129]

It is, therefore, important to safeguard the obligation to ensure a company is aware of any agreement impacting on its rights prior to it becoming enforceable, as the impact may be arbitrary. It was held in *Matthews v Young*[130] that one has an unfettered right to trade freely, a sense of balance must be struck between the contracting parties' obligations, which includes the honouring of their contracts. In order for one to achieve the above, it is imperative for a company to know that an agreement in its name exists. The Supreme Court of Appeal in *Reddy v Siemens Telecommunications (Pty) Ltd*[131] held as follows:

> "… all persons should in the interests of society be productive and be permitted to engage in trade and commerce or the professions. Both considerations reflect not only common-law but also constitutional values. Contractual autonomy is part of freedom informing the constitutional value of dignity, and it is by entering into contracts that an individual takes part in economic life".

The directors and shareholders of a company have a vested interest in the performance of their company and any arbitrary decision taken against the company impacts greatly on their individual rights. As such, it is viewed that in applying principles

[128] (13372/16) [2017] ZAWCHC 105 p 3.
[129] *Oriani-Ambrosini v Sisulu, Speaker of National Assembly* 2012 6 SA 588 (CC) p 64.
[130] 1922 AD 492 par 507.
[131] 2007 2 SA 486 (SCA) p 15.

of deemed ratification, which have an impact on the company's rights and that of its directors and shareholders, that there be a consideration to the principles of public interest and rights in trade or commerce.

5 *Conclusion*

It is essential to create an opportunity to consider a point of liability in the South African approach to deemed ratification. In previous years, it has always been a question of when a promoter is relieved from liability; or when a company becomes liable in instances of a rejection of a pre-incorporation contract; and where a company has not yet been established. This opportunity will allow third parties, promoters and the company to determine the disclosure of the terms of the contract prior to any ratification or rejection by an established company. Furthermore, it would protect the parties against liability and associated litigation. As such, an approach of this nature, therefore, needs consideration.

The lessons from Canada and the United States of America show that a narrow view or a strict application of the rules and provisions regulating pre-incorporation contracts can lead to injustices to the parties involved. At times it is not the parties' intention to engage in complicated transactions but because of statutory provisions, complications arise. However, in order to safeguard the parties' commercial interests and to secure transactions, parties are forced into these associations due to the complicated nature of the arrangement.

Overall, it is clear that the acts,[132] and in particular section 21 of the 2008 Companies Act, are unable to justifiably protect all the parties involved and also prevent the risk of fraud against a company. It is posited that the 2008 Companies Act[133] still does not provide for certain situations, such as the failure to expressly prohibit a third party from unilaterally withdrawing from the agreement before its ratification or rejection by a company has taken place, or by expressly stating whether the contracting parties, pending incorporation, can by agreement, agree to cancel a pre-incorporation contract. These issues can be dealt with by the parties in the contract, in accordance with the normal rules of contract. However, the failure of the 2008 Act to ensure a formal disclosure of the terms of the contract to a corporation creates the opportunity for fraud and does not protect a company and the affected parties' rights to trade; of association and access to information.

It is clear from this research, and in terms of the common law, that the *Kelner* case[134] had established the principle that a company could not enter into a contract prior to its incorporation. This was because it lacked contractual capacity and, therefore, could not be held liable on a pre-incorporation contract entered into on its behalf or entered

[132] Act 71 of 2008 and its predecessors.
[133] s 21 of Act 71 of 2008.
[134] n 36.

into in its name. The court's reasoning in the *Kelner* decision[135] was based on the theory that the company was non-existent at that time, and the contracting parties were aware of this fact but nonetheless purported to contract. In this interpretation, it was then established as a consequent rule that the promoter became personally liable for the contract concluded. In justifying this approach, the parties contracted with the understanding that the promoter had a desire and the necessary ability to bring the company into existence. Furthermore, both parties had an understanding that the company would become a party to the contract upon its establishment, with the inference that the parties with an economic interest in the contracted transaction would become the third party and the promoter, hence the resultant personal liability to the contract.

In the previous discussion it is evident that this approach was accepted until the court, in *NewBorne v Sensolid (Great Britain) Ltd,*[136] established a further limitation on the interpretation to the approach. The decision contended that the *Kelner* case[137] did not create a general approach of automatic personal liability of the promoter in the case of the company remaining non-existent,[138] considering that the factual implication was that the company was contracting, and the company's contract was authenticated by the signature of a director. The contract, therefore, purported to be a contract of the company and not that of its directors, due to the director's confirmation via the company's signature.

The court was of the opinion that although the company was non-existent at the time of conclusion of the contract, the promoter, NewBorne, could not claim enforcement of the contract. As such, it is clear that this interpretation, warrants investigation. The court's observation of the subjective interests of NewBorne in the contract, and his attempt to plead that "it was his contract" when faced with the difficulty of proving the contractual requirement of capacity, indicates the value extended to a party as well as to the pre-incorporation contract prior to the company's incorporation. This observation was acceptable[139] until the confirmation of the *Kelner* approach in *Black v Smallwood.*[140]

The Australian courts declined to hold the directors of a company personally liable in the case of a pre-incorporation contract, concluded for the sale of a piece of land to a company known as Western Suburbs Holdings Pty Ltd, which, at the time of

[135] n 117.
[136] 1954 1 QB 45 (CA).
[137] n 36.
[138] 1954 1 QB 45 (CA) 50.
[139] This was accepted and confirmed in *Richardson v Lancker* (1950) 50 SR (NSW) 250-259. The court emphasised that the lease had not been executed by an agent on behalf of the company; it had been executed by the company by the subscription of its name followed by the signature of a director. As such, the court was of the view that the written instrument (lease) showed that the directors did not enter into the any contract; they were not parties to the contract as agents or otherwise and there was no basis upon which they could be held liable upon it.
[140] *Black v Smallwood* (1996) 117 CLR 52 (HCA) par 39.

conclusion, was not incorporated. The court held that the directors did not contract, or purport to contract, on behalf of the company and the fact that their signatures appeared as part of the company's signature did not make them parties to the contract. Nor could, as was possible in *Kelner,* an intention to be personally bound be imputed to them.[141]

In all these instances, a pre-incorporation contract was used by parties to advance an economic agenda directly or indirectly beneficial to the parties involved in the pre-incorporation stage of the company and the conclusion of a pre-incorporation contract. Whilst this application excludes the company or its corporate organ, the Canadian application of pre-incorporation contracts finds adoption as a basis of accepting liability to a contract by a company[142] with a provision allowing exclusion to benefits.[143] The South African application requires ratification of a pre-incorporation contract with an innovative approach of deemed ratification, which translates into an automatic valid pre-incorporation contract, resulting from a company's election not to reject or ratify a pre-incorporation contract within three months from the date of its incorporation in the event of the contract not being ratified or rejected.

The Canadian approach is one which establishes a default rule of personal liability imparted onto the promoter. This results in the promoter accepting any and all burdens and benefits of a contract in terms of sub-section 1 of section 14.[144] However, it further provides a right of exclusion to personal liability by requiring that parties make it sufficiently clear in writing that the promoter is not to be held personally liable.[145] The adoption process does not provide a consultative opportunity with the incorporated company in order to assess its corporate vision and to protect its identity whilst protecting its rights to maintain a continued business relation or corporate association.

The South African application requires a pre-incorporation contract to be ratified by the company in order to impart liability to the company. The legislation further holds the promoter personally liable for the contract, provided that the contemplated entity is not subsequently incorporated or after the incorporation of the entity, the company rejects all or in part such agreement or action concluded on behalf of, or in the name of, the entity. However, the legislature provides an option to ratify a pre-incorporation contract without any corporate instruction from the company.[146] The legislature has, in a bid to avoid prejudice to third parties, enacted the provision of deemed ratification, as it was thought that a company's corporate organ would wilfully remain inactive or defer a decision to accept or reject the pre-incorporation contract. The legislature considered this conduct unjust and prejudicial to third parties who contracted with the

[141] (n 7) par 60.
[142] s 14(2) of the Canadian Business Corporations Act, RSC 1985.
[143] s 14(4) of the Canadian Business Corporations Act, RSC 1985.
[144] (n 71) above.
[145] (n 143) above.
[146] s 21 Act 71 of 2008.

company under the assumption that the company would, upon incorporation, ratify the contract and they would then find returns on their investments.

The focus of this study is to analyse the application of the principles of pre-incorporation with regard to case law and after such analysis, explore the constitutionality of the provisions of deemed ratification, as provided by the South African legislation that regulates companies and further determine reasonableness or fairness of the provision. The aim of the study is to indicate the opportunity of a fair practical application of the South African position which promotes fairness on the part of the corporation.

The inclusion of pre-incorporation contracts play a vital role in the development of businesses. However, challenges persist in the Canadian and South African jurisdictions. In South African law, the focus is on the actual validity of the contract in terms of section 21 of the Companies Act[147] and the ultimate enforcement of the agreement, without prime focus being on the application of the provisions of the deemed ratification. It is clear that other academics fear that the interpretation of a statutory approach would fail and result in an inflexible approach by the courts which would disadvantage third parties.[148]

It is submitted that, although the aforementioned interpretation and judicial approach may be practical, it does not necessarily mean that it is the only possible disadvantage that may arise. In this regard, it is necessary that the legislature and the courts, in their application of the provisions of deemed ratification, consider the interests of all parties. This should direct a path that could lead to the creation of legal certainty, while avoiding an inflexible approach that has caused prejudice to unrepresented parties when adjudicating matters in terms of section 21(5) of the 2008 Act.

It is further submitted that the Canadian position can indeed be compared to the South African position. This study has shown that, although the provision of deemed ratification are not common in the Canadian and Unites States of America, the concept of assumed adoption allows for a practical comparison which can reach a hypothetical, just and equitable conclusion.

Finally, when the South African courts adjudicate matters regarding the enforcement of a pre-incorporation contract ratified in terms of sub-section 5, they should, in addition to considering the current statutory approach and the common law, also consider the constitutional interests of a corporation as well as any facts related to its knowledge of a pre-incorporation contract and its terms. This should be done to equitably protect the conflicting interests of the parties and to avoid setting arbitrary precedents in the application of the law of pre-incorporation contracts.

[147] Act 71 of 2008.
[148] Ncube (n 27) 260-261.

It is, therefore, recommended that there be an amendment to sub-section 5[149] insofar as the legislature should include a requirement of disclosure of the existence and/or the terms of an agreement to the board of a company. An amendment can be drawn on sub-section 5 to include the words "if a third party is able to prove knowledge of the existence of the contract by the company". Alternatively, a party could be required to prove negligence on the part of a company that has entered into a pre-incorporation contract; specifically, in respect of the manner in which it ratified the impugned contract in terms of sub-section 5, prior to the application of section 6.[150]

Accordingly, the provision of deemed ratification as currently reflected, is not reasonably fair when dealing with the protection of the interest of all parties to the pre-incorporation contract. This is particularly true in the context of a party who is not available at the time of negotiation and subsequent conclusion. It is clear that possible solutions should be made available, in order to avoid the application of the provisions of deemed ratification, wherein parties would rather opt for safer measures, which include the registration of a company prior to contracting, or agreeing on a draft agreement which would later form the basis of a contractual relationship. The law must accommodate situations where parties are chasing economic opportunities, which cannot wait upon the registration of a company or rely on a draft agreement. Therefore, an inclusion in the current Act, which makes sure that a company is aware of the existence of a contract shall ensure all parties involved are protected against any arbitrary consequences.

[149] "If, within three months after the date on which a company was incorporated, the director of that company has neither ratified nor rejected a particular pre-incorporated contract, or action purported to have been or done in the name of the company, or on its behalf, as contemplated in subsection (1), the company will be regarded to have ratified that agreement or action".

[150] "To the extent that a pre-incorporation contract or action has been ratified or rejected to have been ratified in terms of subsection (5) – (a) the agreement is as enforceable against the company as if the company had been a party to the agreement when it was made, and the liability of a person under the subsection (2) in respect of the ratified agreement or action is discharged"."

Bibliography

BOOKS

Benade M L *et al Ondernemingsreg* Butterworths Durban (2008)

Beuthin R C *et al Beuthin's Basic Company Law* Durban Butterworths (2000)

Christie R H *The Law of Contract in South Africa* Durban Butterworths (2006)

Cilliers H S and M L Benade, *Introduction to Company Law* Durban Butterworths (1985)

Cilliers H S *et al Cilliers & Benade Korporatiewe Reg* Durban Butterworths (2000)

Cilliers H S *et al Cilliers & Benade Ondernemingsreg* Durban Butterworths (1999)

Davies P L *Gower and Davies' Principles of Modern Company Law* London Sweet and Maxwell (2003)

Davis D *et al Companies and Other Business Structures in South* Africa Cape Town Oxford University Press Southern Africa (2009)

Du Bois, F Willie's principles of South African Law Cape Town Juta (2007)

Th(1992)

Hutchison D *et al The Law of Contract in South Africa* South Africa Oxford University Press (2009)

Ivamy E R H *Topham and Ivamy's Company Law* London Butterworths (1978)

Kerr A J *The Law of Agency* Durban LexisNexis Butterworths (1991)

Pennington RR *Company Law* London, Dublin and Edinburgh Butterworths (1990)

Pennington RR *Company Law* New York and Great Britain Oxford University Press (2001)

Van der Merwe S *et al Contract General Principles* Cape Town Juta and Company Ltd (2007)

Pinto AR and Brandson DM *Understanding corporate law (US: Matthew Bender & Company* Lexis Nexus (2003)

CASES

Akromed Products Pty Ltd v Suliman 1994 1 SA 673 (T)

Bankers Trust Co of Western New York v Zecher 426 NYS 2d 960 (Sup Ct 1980)

Black v Smallwood 1996 117 CLR 52 (HCA)

Browns' Executrix v McAdams 1914 AD 231

Buffington v Bardon 80 Wis 635 50 NW

Clifton v Tomb 21 F 2d 893 (4th Cir 1927)

Clutcho (Pty) Ltd v Davis 2005 3 SA 486 (SCA)

Commissioner of Inland Revenue v Estate Crewe 1943 AD 656

Crookes v Watson 1956 1 SA 277 (A)

Cushion Heel Shoe Co v Hartt 103 NE 1063 181 Ind 67 LRA NS 979 (1924)

Dealers Granite Corp v Faubion 18 SW 2d 737 (Tex Civ App 1929)

Ferreira v Levin NO and Others; Vryenhoek and Others v Powell NO and Others 1996 1 SA 984 (CC)

Financial Mail (Pty) Ltd v Sage Holdings Ltd 1993 2 SA 451 (A)

Framingham Savings Bank v Szabo 617 F 2d 897 (1st Cir 1980)

Hofer v Kevitt NO 1998 1 SA 382 (SCA)

Jacobson v Stern, 605 P 2d 198 (Nev 1980)

Kelner v Baxter (1866), LR 2 CP 174

Mail (Pty) Ltd V Sage Holdings Ltd 1993 2 SA 451 (A)

Manong & Associates v city manager, City of Cape Town and Another 2009 1 SA 644 (EqC)

Masterpiece Gold Mining Co Ltd v Brown's Executrix 1914 AD 231

Mazibuko and others v City of Johannesburg and Others 2010 3 BCLR 239 (CC)

McArthur v Times Printing Co 51 NW 216 (Minn 1892)

McCullogh v Fernwood Estate Ltd 1920 AD 204

Meyers v Wells 31 NW 2d 512 (Wis 1948)

Mutual Life Insurance Co of New York v Hotz 1911 AD 556 567

NewBorne v Sensolid (Great Britain) Ltd (1954) 1 QB 45 (CA)

Ngcwase v Terblanche 1977 3 SA 796 (A)

Okinczyc v Tessier; Okinczyc v Berket (1979) 8 RPR 249 (Ont HCJ)

Peak Lode Gold Mining Co Ltd v Union Government 1932 TPD 48

Phumelela Gaming and Leisure Ltd v Grundligh and Others 2006 8 BCLR 883 (CC)

Racec (Mooifontein) (Pty) Ltd v Devonport Investment Holding Co (Pty) Ltd 1976 1 SA 299 (W)

Richardson v Lancker (1950) 50 SR (NSW) 250

Sentrale Kunsmis Korp (Edms) Bpk v NKP Kunsmisverspreiders (Edms) Bpk 1970 3 SA 342 (A)

Venalex (Pty) Limited v Vigraha Property CC and Others 2015 2 All SA 645 (KZD)

Wall v Niagara Mining & Smelting Co of Idaho, 59 P399 (1899)

Webber v George F Lance Co 237 F 357 (3d Cir 1916)

Westcom Radio Group Ltd v Maclsaac (1989) 63 D L R (4th) 433 (Ont Div Crt)

York Region Condominium Corp N 921 v ATOP Communications Inc [2003] OJ 5255 (SCJ)

LEGISLATION

British Columbia Company Act RSBC of 1996 (Britain, Canada)

Business Corporations Act RSO of 1970 (Canada)

Canadian Business Corporations Act RSC of 1985 (Canada)

Canadian Business Corporations Act SC of 1974 (Canada)

Companies Act 46 of 1926 (South Africa)

Companies Act 61 of 1973 (South Africa)

Companies Act 71 of 2008 (South Africa)

Companies Amendment Act 46 of 1952 (South Africa)

Constitution of the Republic of South Africa 1996 (South Africa)

Corporate Laws Amendment Act 24 of 2006 (South Africa)

Corporations Act SM of 1976 (Canada)

Ontario Business Corporations Act R.S.O of 1990 (Canada)

Promotion of Access to Information Act 2 of 2000 (South Africa)

JOURNALS

Cassim F "*Pre-incorporation contracts: The reform of section 35 of the Companies Act"* 2007 *SALJ* 364

Easson AJ and Soberman DA "*Pre-incorporation contracts: common law confusion and statutory complexity"* 1992 *Queen's LJ* 414

Ncube CB "Pre-incorporation contracts: statutory reform 2009" *SALJ* 255

Puri P "The promise of Certainty in the law of Pre – Incorporation Contracts" 2002 Canadian Bar Review 1051

Wilfred M Estey "Pre-Incorporation Contracts: The Fog is finally lifting" 2000 Can Bus LJ 33.